S. 652 PAYPHONE PROVISION AND COMMITTEE REPORT

"(G) Consortia of health care providers consisting of one or more entities described in subparagraphs (A) through (F).

"(4) PUBLIC INSTITUTIONAL TELECOMMUNICATIONS USER.—The term 'public institutional telecommunications user' means an elementary or secondary school, a library, or a health care provider as those terms are defined in this subsection.

"(e) TERMS AND CONDITIONS.—Telecommunications services and network capacity provided under this section may not be sold, resold, or otherwise transferred in consideration for money or any other thing of value.

"(f) ELIGIBILITY OF COMMUNITY USERS.—No entity listed in this section shall be entitled for preferential rates or treatment as required by this section, if such entity operates as a for-profit business, is a school as defined in section 264(d)(1) with an endowment of more than $50,000,000, or is a library not eligible for participation in State-based plans for Library Services and Construction Act Title III funds.".

SEC. 311. PROVISION OF PAYPHONE SERVICE AND TELEMESSAGING SERVICE.

Part II of title II (47 U.S.C. 251 et seq.), as added by this Act, is amended by adding after section 264 the following new section:

"SEC. 265. PROVISION OF PAYPHONE SERVICE AND TELEMESSAGING SERVICE.

"(a) NONDISCRIMINATION SAFEGUARDS.—Any Bell operating company that provides payphone service or telemessaging service—

"(1) shall not subsidize its payphone service or telemessaging service directly or indirectly with revenue from its telephone exchange service or its exchange access service; and

"(2) shall not prefer or discriminate in favor of its payphone service or telemessaging service.

"(b) DEFINITIONS.—As used in this section—

"(1) The term 'payphone service' means the provision of telecommunications service through public or semi-public pay telephones, and includes the provision of service to inmates in correctional institutions.

"(2) The term 'telemessaging service' means voice mail and voice storage and retrieval services, any live operator services used to record, transcribe, or relay messages (other than telecommunications relay services), and any ancillary services offered in combination with these services.

"(c) REGULATIONS.—Not later than 18 months after the date of enactment of the Telecommunications Act of 1995, the Commission shall complete a rulemaking proceeding to prescribe regulations to carry out this section. In that rulemaking proceeding, the Commission shall determine whether, in order to enforce the requirements of this section, it is appropriate to require the Bell operating companies to provide payphone service or telemessaging service through a separate subsidiary that meets the requirements of section 252.".

SEC. 312. DIRECT BROADCAST SATELLITE.

(a) DBS SIGNAL SECURITY.—Section 705(e)(4) (47 U.S.C. 605(e)(4)) is amended by inserting "satellite delivered video or audio programming intended for direct receipt by subscribers in their residences or in their commercial or business premises," after "programming,".

(b) FCC JURISDICTION OVER DIRECT-TO-HOME SATELLITE SERVICES.—Section 303 (47 U.S.C. 303) is amended by adding at the end thereof the following new subsection:

"(v) Have exclusive jurisdiction to regulate the provision of direct-to-home satellite services. For purposes of this subsection, the term 'direct-to-home satellite services' means the distribution or broadcasting of programming or services by satellite directly to the subscriber's premises without the use of ground receiving or distribution equipment, except at the subscriber's premises, or used in the initial uplink process to the direct-to-home satellite.".

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TELECOMMUNICATIONS COMPETITION AND DEREGULATION ACT OF 1995

REPORT

OF THE

COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION

ON

S. 652

March 30 (legislative day, March 27), 1995.—Ordered to be printed

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inition of universal service gives the FCC the authority to establish a separate definition of universal service under new section 253(b) for application only to public institutional telecommunications users.

Sec. 311. Provision of pay phone service and telemessaging service

Section 311 of the bill adds a new section 265 to the 1934 Act, to address certain practices of the Bell operating companies with regard to telemessaging and pay phone services. This section is designed to prohibit cross-subsidization between a Bell operating company's telephone exchange or exchange access services and its pay phone and telemessaging services. Existing joint-cost rules are not adequate to prevent such activities.

This section prohibits a Bell operating company from discriminating between affiliated and nonaffiliated pay phone and telemessaging services, under rules set forth by the FCC. These provisions are necessary to ensure the continued participation of small businesses in telemessaging services. The Committee is hopeful that these safeguards will preserve such a competitive environment. If, however, the FCC finds that these safeguards are insufficient, the FCC may require the Bell operating companies to provide telemessaging services through a separate subsidiary.

New section 265 directs the FCC to complete, within 18 months after the date of enactment of the bill, a rulemaking proceeding to prescribe regulations to carry out this new section. The FCC also is directed to determine whether, in order to enforce the requirements of section 265, it is appropriate to require the Bell operating companies to provide pay phone service or telemessaging services through a separate subsidiary that meets the requirements of new section 252, as added to the 1934 Act by section 102 of the bill.

The FCC's rules could include, for example, a prohibition on a Bell operating company's joint marketing of telemessaging and telephone exchange services, unless such a marketing opportunity were also made available to nonaffiliated telemessaging providers on equivalent terms. Prohibited discrimination could also include providing preferential access to customer proprietary network information or network technical information to its own pay phone or telemessaging subsidiary. The rules could also require a Bell operating company to provide the same opportunities for involvement in network planning, design, and implementation to affiliated and nonaffiliated telemessaging providers.

Pay phone services are defined to include the provision of telecommunications service through public or semipublic pay telephones, and includes the provision of inmate phone service in correctional institutions.

Public pay phones are a regulatory anomaly. Public pay phone competition did not emerge until after the AT&T divestiture. By then, the FCC had completed the broad outlines of the framework for regulating the Bell operating company's telecommunications offerings that are competitive with services offered by independent providers. As a result, the regulatory status of public pay phones has been inadequately addressed.

At divestiture, the Bell System public pay phones were assigned to the Bell operating companies. Public pay phones were simply treated as a part of local exchange service because only the local telephone companies provided this service. Similarly, at the time of the FCC's Computer II[2] decisions, Bell operating companies' public pay phones were technologically dependent on central office switch functionality for monitoring and control of all aspects of coin calling (a dependence which largely persists today, but primarily because of Bell operating company choice rather than technological imperative). Public pay phones were, therefore, treated as a "basic service" offering. The Bell operating companies were allowed to bundle both the network access line and the pay station terminal equipment; the Bell operating companies were not required to unbundle the pay station from the central office functionality and network support service, as was done with all other customer premises equipment. Similarly, unlike other customer premises equipment, pay telephone terminal equipment was not deregulated and was not removed from regulated accounts. See Tonka Tools, Inc., FCC 85-269, 58 RR2d 903 (1985).

Shortly after divestiture, technological constraints that had dictated the FCC's treatment of public pay phones in Computer II and the MFJ's assignment of pay phones to the Bell operating companies were overcome. Independent public pay phone providers developed the technology to use onboard microprocessors to replicate in the telephone terminal itself most of the control and supervision functions performed by the central office for Bell operating company public pay phones. The FCC recognized the right of independent public pay phone providers to interconnect these "instrument-implemented" devices to the interstate network. *Registration of Coin Operated Telephone*, FCC 84–270, 57 RR2d 133 (1984). The FCC left to the States the authority to regulate intrastate rates and other terms of interconnection. *Universal Pay Phone Company*, FCC 85–222, 58 RR2d 76 (1986). The States have regulated the rates charged to end users by independent public pay phones providers and the rates charged by Bell operating companies to independent public pay phones providers for the local exchange services the independent public pay phone providers use in offering service to the public.

Independent public pay phone providers have emerged to provide some competition to local exchange company public telephones. But neither Federal nor State legislators or regulators have gone back to reexamine the anomalous "dual regulatory" regime under which pay phone competition has grown. On the one hand, independent public pay phone providers offer their pay phones as deregulated customer premises equipment and purchase local exchange facilities from the telephone company on a tariffed, arm's-length basis. On the other hand, telephone companies offer their public pay phone services as a bundled offering of network services and premises equipment that are totally integrated into local exchange operations. There is thus the incentive and the potential for all the forms of discrimination, cross-subsidy, and leveraging of bottleneck

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[2] Amendment of Section 64.702 of the Commission's Rules and Regulations, ("Second Computer Inquiry"), Final Decision, 77 FCC 2d 384 ("Computer II Final Decision"), recon., 84 FCC 2d 50 (1980) ("Computer II Reconsideration"), further recon., 88 FCC 2d 512 (1981), aff'd sub nom. Computer and Communications Indus. Ass'n v. FCC, 693 F.2d 198 (D.C. Cir. 1982), cert. denied, 461 U.S. 938 (1983), second further recon., FCC 84–190 (released May 4, 1984).

facilities that both the divestiture and the FCC's regulatory regime for competitive Bell operating company offerings are supposed to prevent.

Semipublic pay phones are also included within the definition of pay phone services. Although the cost of maintaining a semipublic pay phone is paid for by the location owner, whereas the cost of a public pay phone is borne by the pay phone provider, semipublic pay phones are similar to public pay phones in that both services are offered by the Bell operating companies on a bundled basis and are integrated into local exchange operations. Therefore, semipublic pay phones also are included in new section 265's definition of pay phone service. Section 265 also includes inmate phone systems within the definition of pay phone service.

New section 265 is intended to promote a more evenhanded competitive environment. In order to address the competitive imbalance, the Bell operating companies are prohibited from cross-subsidizing and from preferring or discriminating in favor of their own pay phone operations. The FCC should consider applying to pay phone services the same guidelines designed to prevent cross-subsidy and discrimination in the Bell operating company's offering of other customer premises equipment.[3] Bell operating companies should provide the same treatment to their own and competitors' pay phones with respect to rates, terms, and conditions of interconnection to network facilities and other carrier services on which pay phone operations depend. The FCC is directed to conduct rulemaking proceedings to implement new section 265.

Nothing in Section 265 is intended to limit the authority of the FCC to address these structural issues, or other pay phone related issues, under the existing provisions of the 1934 Act. The Committee believes the FCC already has authority to address these issues. Indeed, a petition requesting the FCC to address these issues has been pending for almost 7 years.[4] Section 265 is intended to ensure that these longstanding problems are addressed.

There may be special issues to be addressed regarding pay phone services. For instance, there may be situations where it is desirable to have public pay phones placed in certain areas where the volume of traffic would not otherwise justify a pay phone. Examples might include some public schools, certain sections of some cities, certain rural areas. Nothing in this section is intended to remove the current authority of the FCC or the States to address these issues, or to prevent the FCC or the States from regulating pay phone service, including the regulation of rates to end users charged by all public phone providers, both independent companies and the Bell operating companies.

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[3] See e.g., In the Matter of Separation of Costs of Regulated Telephone Service From Costs of Nonregulated Activities: Amendment of Part 31, the Uniform System of Accounts for Class A and Class B Telephone Companies, to Provide for Nonregulated Activities and to Provide for Transactions between Telephone Companies and their Affiliated, 104 FCC2d 59 (1986).

[4] In the Matter of the Public Telephone Council, Petition for Declaratory Ruling that Bell Operating Company Pay Telephones are Customer Premises Equipment for Regulatory Purposes, filed July 18, 1988.

ISSUES RELATED TO
UNBUNDLING OF LEC PUBLIC PAYPHONE SERVICE

Prepared by the
American Public Communications Council
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ISSUES RELATED TO UNBUNDLING OF LEC PUBLIC PAYPHONES

A number of issues and concerns have been raised as a result of the petition for declaratory ruling filed by the Public Telephone Council ("PTC") regarding "unbundling" of Bell Operating Company ("BOC") provided pay telephones.[1] The PTC petition seeks a declaratory ruling that BOC pay telephones are customer premises equipment ("CPE") under the regulatory policies of the Federal Communications Commission, and therefore must be unbundled from the associated local exchange service and removed from the local exchange rate base. While the PTC petition focuses primarily on the payphones operated by the BOCs, the proposed unbundling requirement logically would apply, and should apply, to all local exchange carriers ("LECs"). The purpose of this memorandum is to address some of the issues that have arisen regarding the effect that granting PTC's petition would have on the pay telephone industry, state regulatory authority, and on consumers of telephone service.

The issues raised are important, but fortunately, there are precedents for addressing them. Very similar issues were raised and successfully addressed by the Federal Communications Commission and state public utilities commissions (PUCs) following the original Computer II[2] ruling that "unbundled" and detariffed other

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1 In the Matter of the Public Telephone Council, Petition for Declaratory Ruling that Bell Operating Company Pay Telephones are Customer Premises Equipment for Regulatory Purposes, filed July 18, 1988.

2 Second Computer Inquiry, Final Decision, 77 FCC 2d 384, on reconsideration, 84 FCC 2d 50 (1980), further reconsideration, 88 FCC 2d 512 (1981), aff'd sub nom. Computer and Communications

carrier-provided CPE. Therefore, in addressing the unbundling of pay telephones, the Commission will not be writing on a blank slate. By successfully addressing similar issues in implementing Computer II, the Commission has shown that there are proven methods for dealing with the concerns raised.

I. BACKGROUND

The basis for PTC's petition is that in today's environment there is no legitimate basis for continuing to treat carrier-provided payphones as a special category of equipment that is exempt from the Commission's Computer II rules. In an earlier ruling, Tonka Tools,[3] the Commission ruled that carrier-provided pay telephones were not "CPE" for purposes of Computer II, because the equipment was not severable from the underlying transmission capacity. As a result of the growth of competition in the payphone market, the basis for whatever validity the Tonka Tools decision may have had has been undermined. With the growth of payphone competition, there is now a wide range of competitive alternatives available for installation of payphone equipment to serve payphone users. The justification for excluding pay telephones from regulatory classification as CPE is no longer applicable.

Industry Ass'n v. FCC, 693 F. 2d 198 (D.C. Cir. 1982), cert. denied, 461 U.S. 938 (1983).

3 Petition for Declaratory Ruling of Tonka Tools, Inc. and Southern Merchandise Corp., 58 RR 2d 903 (1985).

For end users, key benefits of payphone competition have been increased availability of payphones and a greater variety of innovative services offered to the public. Competition also helps to ensure that payphone equipment is conveniently placed and more efficiently maintained. With competition, end users have more efficient payphone service available in more convenient locations.

By bundling pay telephone equipment with the underlying transmission service, however, the LECs are currently able to provide themselves with much more favorable rates than they provide to COCOTs for identical transmission service. This gives the LECs an unfair competitive advantage over the COCOTs and deprives the consumer of the full range of competitive choices. Bundling also distorts market forces by preventing a correct allocation of costs between competitive and monopoly offerings.

Unbundling of LEC pay telephone equipment from the underlying transmission service is an essential step toward ending the discriminatory practices that prevent full and fair competition and toward ensuring the proper allocation of costs.

In effect, forcing LECs to remove payphones from their rate base would tend to level the competitive "playing field." The LECs would be directed to treat their payphone operations as separate business units for accounting purposes and would be subject to the FCC rules for cost allocations between regulated and unregulated activities. The LEC's payphone operations would be required to pay the same tariffed charges for installation, basic dial tone, usage, directory assistance, and other such services as those paid by competing payphone operators. Clearly, the public interest will be served by ensuring that the profitability of payphone providers depends on their ability to efficiently manage their own costs, and not on their being exempted -- by virtue of affiliation with the LEC -- from the interconnection and transmission charges imposed on competitors.

While the changes in the payphone marketplace clearly support a decision declaring that all pay telephones are CPE for regulatory purposes, a number of concerns have been raised as to the effect that such a ruling would have on state regulation of the payphone industry as well as the payphone industry itself. Among those concerns are: (1) whether state regulators would lose their power to regulate payphone service; (2) the effect that such a declaration would have on the availability of so-called "public service" payphones; (3) the actual method of removing payphones from the rate base; and finally (4) the possible loss of an interstate "contribution" to local service costs.

Each of these concerns has been raised before in the context of the FCC's <u>Computer II</u> decision that required detariffing and "unbundling" of virtually all other residential and commercial CPE. In its implementation of that decision, the Commission devised solutions to those problems which are applicable in either the same

II. IMPACT OF UNBUNDLING ON STATE REGULATION OF PAYPHONE RATES

Some concern has been expressed regarding the effect that unbundling of pay telephones would have on state regulatory authority. Specifically, state PUCs have raised the concern that a declaration by the Commission that pay telephones are CPE would cause state regulators to lose their regulatory control over rates paid by end users for intrastate payphone service. A related concern is that unbundling pay telephones could affect the state's authority to regulate conditions of payphone service, including emergency calls, directory assistance, return of payment, complaint resolution, and payphone maintenance.

Granting the PTC Petition will not deprive the state PUCs of regulatory authority over the rates or conditions for intrastate payphone service. Identical issues of state regulatory authority over the resale of services on a customer's premises were raised and resolved in a series of FCC decisions in the years following the Computer II ruling.

For example, independently provided payphones ("IPPs," also known as "customer owned, coin operated telephones," or "COCOTS") are treated as CPE for regulatory purposes. Payphone owners cannot be prohibited from interconnecting payphones to the network, and the payphone equipment is not subject to rate regulation. However, the Commission has recognized that intrastate telephone service provided at the payphone is subject to state regulation as the resale of intrastate common carrier service.[4] By requiring LEC provided payphones to be unbundled from local exchange service, the Commission would be placing those payphones in the same regulatory status as IPPs. The provision of the payphone itself would not be subject to regulation, but the provision of service to end users at the payphone would be subject to state regulation as the resale of telephone service, to the same extent that the service provided at IPPs is regulated today.

Additional precedents for the authority of states to regulate resold services that use CPE result from decisions on shared tenant services, and on hotels and motels following the Commission's Computer II decision. The result in each case was that, even though the equipment was classified as CPE, state regulatory authority over the resold local services was upheld.

In the FCC's shared tenant services ("STS") proceedings, concerns were raised by state regulators that the Commission's rulings regarding CPE interconnection rights would result in the preemption of the state's authority to restrict or prevent the resale of local services by an STS system. While the Commission did rule that CPE users had the right to interconnect the CPE used to provide STS services with the underlying network services, the Commission explicitly refused to extend those rights to permit the

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[4] Universal Payphone Corporation, 58 RR 2d 76 (1985). In this case, the Commission declined to preempt a determination by the Minnesota Public Service Commission (MPSC) that an entity offering purely local or intrastate service on a resale basis is a utility and as such is subject to state regulation of intrastate rates and rate structures.

CPE user to resell local service in contravention of state regulation.[5]

Similarly, in the matter of resale of services by hotels and motels, a declaratory ruling was sought that state regulators could not prohibit hotel or motel operators from collecting a surcharge on all intrastate telephone calls made from their facilities. Again, the Commission recognized the state's regulatory authority to establish intrastate telephone charges and to regulate the resale of intrastate services by hotels or motels.[6]

These decisions establish that if LEC payphones are declared to be CPE and are unbundled from local exchange service, state regulators would retain authority to regulate intrastate service provided at such payphones. Thus, state regulators would continue to have the power to set maximum rates for local payphone calls. It would remain within a state's discretion to decide whether or not payphone operators could charge end users for directory assistance calls. In addition, state regulators would continue to be able to control rates for intrastate long distance and associated operator service at payphones. Other terms and conditions of payphone service, such as adequate maintenance and repair, the provision of directories, etc., would remain subject

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[5] International Business Machines Corporation, Memorandum Opinion and Order, File No. ENF 85-45, FCC 86-25, released January 27, 1986; Policies Governing the Provision of Shared Telecommunications Service, 65 RR 2d 956 (1988).

[6] Intrastate Telephone Surcharges by the Lodging Industry, Memorandum Opinion and Order, Common Carrier Bureau, Mimeo No. 5077, released June 12, 1985.

to state regulation, just as IPPs are subject to such regulation today.

State regulators also would retain the authority to approve the rates paid by payphone operators for intrastate service and connections. Payphone owners could be charged regular business line rates or a special rate applicable only to payphones. Additional charges could continue to be set for special payphone services, such as line screening or call blocking. State PUCs could maintain these rates at levels sufficient to generate whatever level of contribution or subsidy is considered appropriate. The critical difference would be that LEC payphones as well as IPPs would be subject to all the rates and conditions established for service to payphones.

All of these areas of regulation would remain subject to the authority of the state PUCs.

III. PUBLIC SERVICE PAYPHONES

The issue of so-called "public service" payphones, i.e., payphones in unprofitable locations which would not be provided payphone service in the absence of public utility regulation, has been raised as an area of concern if payphone equipment is declared to be CPE for regulatory purposes. The universe of these "public service" payphones is not as great as some may believe. In fact, the traditional means of providing service to unprofitable locations is for premises owners to subscribe to "semi-public" payphone service whereby the premises owner is charged for the payphone service. With "semi-public" payphone service, the premises owner's willingness to pay for the service ensures that the LEC does not lose money by serving the location. Thus, payphones connected to "semi-public" service should not be classified as "public service" payphones. In any event, semi-public service or the equivalent can continue with or without unbundling of pay telephone service.

In addition to "semi-public" service, there are other mechanisms whereby payphones are provided and will continue to be provided to "unprofitable" low-volume locations. Given the bargaining power available to premises owners, such as municipal and county governments, that own numerous payphone locations, market forces are now ensuring and will in the future ensure that many locations which might be unprofitable standing alone will be combined in a package that is highly attractive to competitive bidding.[7]

In any event, there are various methods that can be employed to ensure that "public service" payphones continue to be provided in unprofitable locations. The issue of preserving the availability of "public service" payphones is very similar to issues that have been successfully addressed under the <u>Computer II</u> CPE regulatory scheme.

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[7] For example, in the context of competitive bidding for municipal and county contracts, in order to be selected as the provider of payphones to high-volume locations on government property, providers are ordinarily required to serve low volume locations as part of the overall service placed for bid.

Following the Commission's Computer II ruling, the National Association of Regulatory Utility Commissioners raised concerns that, as a result of the deregulation of CPE, the telephone company and other CPE suppliers would find it unprofitable to provide CPE outlets in isolated rural areas, and subscribers living in those areas would no longer have access to a supplier of CPE.[8] The Commission ruled that for a two-year period following the decision, states could require telephone companies to provide telephone services to customers requesting them. The Commission reasoned that in this way, consumers in isolated areas would be temporarily protected from loss of service pending the accumulation of actual experience under deregulation. In fact, during the two-year period the states' authority did not have to be exercised.

In the context of pay telephone service, even more options are available to protect "public service" payphones. For example, the state commissions could require imposition of a special rate element surcharge on all payphone lines and use funding from the surcharge to provide the subsidies required by payphone operators to offer service at unprofitable public service locations. Another option would involve the allocation of public service payphones among all payphone providers based upon a defined formula such as the total number of non-public service payphones which each company provides in the given service area. As in the case of the Computer

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[8] National Association of Regulatory Utility Commissioners, 53 RR 2d 1609 (1983).

II decision, the unbundling of payphones can and should leave these options available in the event they are needed.

However, it should be pointed out that as proved to be the case in Computer II, actual experience may demonstrate that the number of currently served locations that would be unprofitable to serve on an unbundled basis is extremely small. As discussed above, there are various mechanisms, including "semi-public" type service and packaging of multi-location contracts, whereby premises owners customarily ensure service to low-volume locations.

In summary, it is clear that deregulation will not jeopardize "public service" payphones. There are various methods that can be employed to ensure that service is provided to those low-volume locations that cannot be served through existing market mechanisms.

IV. REMOVING PUBLIC PAYPHONES FROM THE RATE BASE

Another concern that has been raised has to do with the actual method for removing payphones from the LEC rate base without causing adverse effects on the general body of ratepayers. In order to remove LEC payphone equipment from the rate base for underlying network services, LECs would be directed to shift all their public payphone operations into "unregulated" payphone operation accounts. Those accounts would be assigned the costs of the payphone equipment and the salaries of all full-time sales staff, administrators, and repair workers, among others. The costs of facilities, employees and other resources which service the payphone unit as well as other units could be allocated as provided in the Commission's joint cost rules.

A. Ensuring Fair Valuation of Transferred Assets

One issue which arises from the shift of LEC payphone operations into unregulated accounts is the valuation of the payphone assets which are transferred from the rate base to the payphone unit accounts. The transfer of these assets must be done in a way that ensures that regulated ratepayers are adequately compensated for the value of assets removed from regulated service. This same issue was addressed and resolved in the mid-1980's when LECs were required to detariff their other CPE. While the possible undervaluation of LEC payphones would clearly be a concern, there are viable mechanisms to prevent such undervaluation.[9]

B. Impact of Unbundling on "Contribution"

A related issue has to do with the impact that payphone unbundling would have on any "contribution" to fixed telephone company costs generated by the inclusion of payphones in a LEC's rate base.

The concern which has been raised is based on similar issues raised in the Computer II decision. At that time, it was believed that regulated rates for CPE that were approved at the state level

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[9] Transfer mechanisms were developed by the Commission in the Computer II decision. The Commission developed guidelines for the transfer of assets which required embedded CPE to be transferred at net book value. See Detariffing of CPE (Second Computer Inquiry), 95 FCC 2d 1276 (1983).

generally were sufficient to recover the entire cost of CPE. Accordingly, the portion of LECs' interstate "settlements" revenues that resulted from the assignment of a large percentage of CPE investment to the interstate jurisdiction[10] was considered to be a "contribution" to the fixed non-CPE costs of the local network.[11] Therefore, it was feared that the sudden removal of CPE from the rate base would have a serious adverse impact on local service rate levels.

To address this problem, the Commission adopted a "phase-out" approach in the Computer II proceeding.[12] After December 31, 1982, no new CPE could be added to the regulated accounts. However, LECs were permitted to continue to recover an "enhanced" interstate contribution for the CPE that already existed on their books as of December 31, 1982 (at net book value), as well as the associated average annual expenses. The LECs were permitted to write off the

10 Traditionally, a significant percentage of LECs' non-traffic sensitive (NTS) costs were assigned to the interstate jurisdiction and were recovered from usage-sensitive long-distance rates. However, the proportion of LECs' NTS costs recovered from interstate long-distance rates has diminished significantly since the FCC instituted "subscriber line charges" (SLCs) to collect the bulk of interstate NTS costs. The interstate NTS costs of LEC public payphones and payphone lines, however, are still required to be assigned to the carrier common line (CCL) charge which is paid by long distance carriers. 47 CFR § 69.501(d). Thus, the interstate NTS costs attributed to LEC payphones are still ultimately recovered from interstate long distance rates.

11 Amendment of Part 67, 89 FCC 2d 1 (1982).

12 Computer II Reconsideration, 84 FCC 2d 50 (1980).

so-called "embedded" CPE over a five-year period,[13] thereby permitting the LECs and PUCs to adjust gradually to the loss of any CPE "contribution" to recovery of local network costs.[14]

A "phase-out" mechanism of some kind is one possible alternative for addressing similar problems if they are found to exist with respect to payphones. However, it is unlikely that such a mechanism will be needed. First, payphones are a much smaller part of the local exchange rate base than CPE was at the time of Computer II. For these reasons, the removal of payphones from the rate base is very unlikely to have a significant impact on local rate levels. Second, the best information available to APCC indicates that, far from recovering all their costs, LEC payphone operations generally do not even recover their interstate costs. If that is the case, then the removal of payphones from the rate base would not deprive ratepayers of an interstate "contribution" and would not have any adverse affect on local exchange rates. Finally, to the extent that it is deemed necessary to ensure a contribution from payphone service to the local rate base, that

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13 Amendment of Part 67, Recommended Decision and Order, FCC 81-566, 46 Fed.Reg. 63345 (Dec.31, 1981), adopted by the FCC in Decision and Order, 89 FCC2d 1 (1982).

14 The use of a fixed five-year write-off period was chosen by the Commission to eliminate any incentive that the LECs might have to delay the sale or transfer of CPE. Given that the LEC was permitted a fixed write-off, irrespective of whether the LEC actually retained possession of the CPE, the LEC would have no incentive to hold onto the CPE. In fact, the Joint Board, appointed by the FCC to adopt transition mechanisms, modified its recommendation to permit LECs to freeze their CPE "base amount" before December 31, 1982, and thus begin disposing of CPE sooner. Amendment of Part 67, Decision and Order, 90 FCC 2d 52 (1982).